TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1964

No. 486

W. PALMER DIXON, ET AL., PETITIONERS,

v.

UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 11, 1964
CERTIORARI GRANTED DECEMBER 14, 1964

SUPREME COURT OF THE UNITED STATES

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IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Docket No. 28752

W. PALMER DIXON, JOAN DIXON, EVERETT W. CADY, CLARISSA H. CADY, J. HERBERT HIGGINS, MARION BLAIR HIGGINS, STEPHEN A. KOSHLAND, CAROL F. KOSHLAND, HENRY A. LOEB, JOHN L. LOEB, CARL M. LOEB, JR., and MARGARET L. KEMPNER, as Executors of the Last Will and Testament of CARL M. LOEB, SR., Deceased, HENRY A. LOEB, JOHN L. LOEB, CARL M. LOEB, JR. and ALAN H. KEMPNER, as Executors of the Last Will and Testament of ADELINE M. LOEB, Deceased, JOHN L. LOEB, FRANCES L. LOEB, HENRY A. LOEB, LOUISE S. LOEB, CLIFFORD W. MICHEL, BARBARA R. MICHEL, MARK J. MILLARD, CLAIRE MILLARD, HENRY PARISH, 2nd, DOROTHY PARISH, HUBERT R. A. SIMON, SAMUEL L. STEDMAN and GERDA C. STEDMAN, Plaintiffs-Appellants,

HELEN J. GERNON and HELENE G. HIRSON, as Executrices of the Last Will and Testament of FRANK E. GERNON, Deceased, HELEN J. GERNON, Plaintiffs,

against

THE UNITED STATES OF AMERICA, Defendant-Appellee.

APPENDIX TO APPELLANTS' BRIEF—Filed March 30, 1964

STATEMENT UNDER RULE 15(b)

This action was commenced on May 27, 1960, by the filing of a complaint in the United States District Court, Southern District of New York. Plaintiffs seek the recovery of income taxes illegally and erroneously assessed and collected from them. The defendant's answer was filed on September 1, 1960.

[fol. 2] On June 11, 1963, defendant filed a notice of motion for summary judgment. Thereafter, and on August 29, 1963, plaintiffs filed a cross-notice of motion for summary judgment. Both motions were heard before the Honorable Richard H. Levet.

Judge Levet filed his opinion on November 1, 1963, granting defendant's motion for summary judgment. Judgment was filed on November 14, 1963, granting defendant's motion for summary judgment; denying plaintiffs' cross-motion for summary judgment; and dismissing the amended complaint with prejudice.

The appeal was taken on January 7, 1964, with the filing of a notice of appeal.

[fol. 3] IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

JUDGMENT—November 14, 1963

This cause came on to be heard on defendant's motion for summary judgment and plaintiffs' cross-motion for summary judgment, as authorized by Rule 56 of the Federal Rules of Civil Procedure, and on plaintiffs' motion for leave to amend their complaint, and the Court having filed an order on October 15, 1963 granting the motion for leave to amend, and it appearing to the Court that with respect to the defendant's motion for summary judgment, there is no genuine issue as to any material fact, and the Court having heard the arguments of counsel, and having filed its opinion herein on November 1, 1963, granting the motion of the defendant for summary judgment and denying plaintiffs' cross-motion for summary judgment, it is

Ordered and adjudged, that plaintiffs may file an amended complaint in the form attached hereto; and it is

Further ordered and adjudged, that defendant's motion for summary judgment be, and the same hereby is, in all respects granted; and it is

Further ordered and adjudged, that plaintiffs' cross-motion for summary judgment be, and the same hereby is, in all respects denied; and it is

Further ordered and adjudged, that the amended complaint of the plaintiffs be, and the same hereby is, dismissed with prejudice; and it is

[fol. 4] Further ordered and adjudged, that the defendant recover from the plaintiffs the sum of $20.00 costs as taxed by the Clerk of the Court.

Dated: New York, N. Y., November 14th, 1963.

Richard H. Levet, United States District Judge.

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

NOTICE OF APPEAL—Filed January 7, 1964

Notice is hereby given that W. Palmer Dixon, Joan Dixon, Everett W. Cady, Clarissa H. Cady, J. Herbert Higgins, Marion Blair Higgins, Stephen A. Koshland, Carol F. Koshland, Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr., and Margaret L. Kempner, as Executors of the Last Will and Testament of Carl M. Loeb, Sr., Deceased, Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr. and Alan H. Kempner, as Executors of the Last Will and Testament of Adeline M. Loeb, Deceased, John L. Loeb, Frances L. Loeb, Henry A. Loeb, Louise S. Loeb, Clifford W. Michel, Barbara R. Michel, Mark J. Millard, Claire Millard, Henry Parish, 2nd, Dorothy Parish, Hubert R. A. Simon, Samuel L. Stedman and Gerda C. Stedman, plaintiffs above-named, hereby appeal to the Court of [fol. 5] Appeals for the Second Circuit from that part of the final judgment entered in this action on the 14th day of November, 1963, which granted defendant's motion for summary judgment, from that part of the said final judgment which dismissed with prejudice the plaintiffs'

amended complaint, and from that part of the said final judgment which denied plaintiffs' cross-motion for summary judgment.

Dated: New York, New York, January 6, 1964.

Stroock & Stroock & Lavan, By: Bernard E. Brandes, A Member of the Firm, Attorneys for Appellants, Office & P. O. Address, 61 Broadway, New York 6, New York, HAnover 5-5200.

To: Robert M. Morgenthau, United States Attorney for the Southern District of New York, Attorney for Respondent, United States Court House, Foley Square, New York, N. Y.

[fol. 6] IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

OPINION—November 1, 1963

LEVET, D. J.:

These are cross motions for summary judgment in an action for refund of federal income taxes paid by the plaintiffs for the taxable year 1952 in the sum of $369,329.65 plus interest. Jurisdiction is based upon 28 USC § 1346(a). The parties agree, except for one fact, which will be dealt with later, that there are no issues as to any material facts.

The facts surrounding this claim for refund are as follows.

During the year 1952, the plaintiffs were partners in the investment firm of Carl M. Loeb Rhoades & Co. (hereinafter "partnership"), a member of the New York and American Stock Exchanges. The principal sources of income of the partnership are from commissions earned on sales of customers' securities, the underwriting and selling of securities and from trading and investing on its own account.

During 1952, the partnership acquired 33 short-term non-interest bearing notes, commonly known as commercial paper. All of the notes were issued at a discount which

ranged from 2⅜ to 3¾% on the face value of the notes. The notes were purchased either directly from the issuing obligor corporation or through agents or dealers on the original date of issue. The notes had maturity dates between 190 and 272 days from the date of issue. All of these notes were either sold subsequent to six months after their purchase or were retained, unmatured, at the close of the taxable year 1952.

Plaintiffs reported the distributive share of the profit realized from the sale by the partnership of 20 of the notes during the year 1952 as long-term capital gain. The Internal Revenue Service disallowed capital gain treatment and computed the discount earned per day for each note by [fol. 7] dividing the number of days between issuance and maturity into the total discount. The earned discount per day, multiplied by the number of days the notes were held during 1952, either before sale or as of December 31, was considered as "discount earned." The Internal Revenue Service treated the amount of "discount earned" as ordinary income. Deficiencies were assessed against the plaintiffs. The deficiencies were paid, a claim for refund was duly filed, and this action was thereafter commenced.

The parties differ as to the treatment which should be accorded to the original issue discounts. The plaintiffs claim that the amounts so realized are long-term capital gains, while the Internal Revenue Service held them to be interest, therefore, ordinary income. In addition, the plaintiffs urge the Commissioner of Internal Revenue's prior acquiescence in 1944 in the case of Commissioner v. Caulkins, 144 F. 2d 482 (6 Cir. 1944), affirming 1 T. C. 656 (1943), estops the Internal Revenue Service from now claiming that original issue discounts should be treated as interest since they relied on the Caulkins' acquiescence when they purchased the securities in 1952.

Thus, the issue is squarely before the court: Aside from any consideration of reliance or estoppel, when short-term non-interest bearing notes are purchased at a discount, is the amount of such discount when realized in the nature of interest or a capital gain?

Discussion

A. Statutes Involved

There are two sections of the Internal Revenue Code of 1939 which must be considered in determining this action. They are Sections 22 and 117(a)(1). Section 22 provides:

"§ 22. Gross income

"(a) General definition. 'Gross income' includes gains, profits, and income derived from salaries, wages, [fol. 8] or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

Section 117(a)(1) provides:

"§ 117. Capital gains and losses

"(a) Definitions. As used in this chapter—

"(1) Capital assets. The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

"(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

"(B) property, used in his trade or business, of a character which is subject to the allowance for de-

preciation provided in section 23(l), or real property used in his trade or business;

"(C) * * *

[fol. 9] "(D) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest [sic] at a fixed maturity date not exceeding one year from the date of issue."

B. Does the 1939 Code Allow Original Issue Discounts to Be Treated as Capital Gains?

The plaintiffs rely heavily upon the case of George Peck Caulkins, supra. The Caulkins case involved a taxpayer who paid $15,043.33 over a ten-year period for an accumulated installment certificate which returned him $20,000 at the end of the ten years when the certificate was redeemed. The Tax Court and the Circuit Court of Appeals for the Sixth Circuit held that the difference between the amount paid and the amount received by the taxpayer upon redemption was a long-term capital gain. This result was achieved primarily through a peculiar application of Section 117 (f), which provided:

"(f) Retirement of bonds, etc. For the purposes of this chapter, amounts, received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

The two courts were of the opinion that $4,956.67 increment received by the taxpayer was a capital gain because Section 117(f) makes the amounts received by the holder on retirement of a certificate or other evidence of indebtedness capital gains. Therefore, on the basis of the Caulkins

[fol. 10] case, the plaintiffs urge that the increment as a result of an original issue discount on a note sold before maturity would result in a capital gain and not ordinary income.

C. The Caulkins Case Was Wrongly Decided.

It is clear that the Courts in the Caulkins case wrongly interpreted the purpose and scope of Section 117(f). The situation which gave rise to the enactment of Section 117(f) is illustrated by the case of Fairbanks v. United States, 306 U. S. 436 (1939). There, the taxpayer acquired bonds at less than par value. The court held that the increment received upon the retirement of the bonds could not be considered as capital gains because the redemption of the bonds was not a "sale or exchange thereof" and the statute defined a capital gain as meaning "taxable gain from the sale or exchange of capital assets". Following the Fairbanks case Section 117(f) was enacted.

It seems plain that Section 117(f) was not designed to accomplish any other purpose but to reverse the type of result achieved in the Fairbanks case. Nowhere in the text of Section 117(f) or in its legislative history is there any indication that if, upon retirement of such bonds, the increment a taxpayer receives would be converted into capital assets or treated as capital gains.

The literal language of Section 117(f) if applied to facts identical to those in the Caulkins case, supra, yields only one conclusion, the increment should be treated as ordinary income. The operative words of Section 117(f) are: "Amounts received by the holder upon retirement * * * shall be considered as amounts in exchange therefor". In a Caulkins-type fact situation, we have a combination of both a capital asset (the notes or other evidence of indebtedness) and the interest on other earnings from that asset. The courts in Caulkins failed to realize that the gain realized from the deemed sale of a capital asset which has appreciated in value is capital gain, whereas, gain realized by income from the capital asset is ordinary income. The [fol. 11] court, in other words, considered both the capital asset and the increment by way of interest or discount to-

gether and considered the combined amount as a capital gain.

The rationale of the Caulkins case has been repudiated in recent years by other courts which had cases similar to Caulkins. See Commissioner v. Morgan, 272 F. 2d 936 (9 Cir. 1959); Rosen v. United States, 288 F. 2d 658 (3 Cir. 1961); United States v. Harrison, 304 F. 2d 835 (5 Cir. 1962), cert. denied 372 U. S. 934 (1963); Pattiz v. Commissioner, 311 F. 2d 947 (Ct. Cl. 1963); Richard B. Gibbons, 37 T. C. 569 (1961); V. David Leavin, 37 T. C. 766 (1962).

THE PLAINTIFFS' CLAIM OF RELIANCE UPON THE CAULKINS ACQUIESCENCE

The plaintiffs claim that they relied on the Caulkins case and the acquiescence in Caulkins by the Treasury Department when they entered into these transactions in 1952. Since Caulkins has been repudiated by the Commissioner, the plaintiffs contend that to apply this change of position to them would cause them substantial injury.

The law is clear that the Commissioner of Internal Revenue can retroactively correct a mistake of law even where a taxpayer has relied on the previous determination to his detriment. Manhattan General Equipment Co. v. Commissioner, 297 U. S. 129 (1936); Helvering v. Reynolds, 313 U. S. 428 (1941); Automobile Club of Michigan v. Commissioner, 353 U. S. 180 (1957); 10 Mertens, Law of Federal Income Taxation § 60.16 (Zimet Rev. 1958). Therefore, it is clear that plaintiffs' alleged reliance, even if proved, does not estop the Commissioner from applying the correct legal principles in determining the income of the partnership. Therefore, we deem it unnecessary to pass upon this claim of reliance.

[fol. 12] Assuming, arguendo, that the law would allow the claim of reliance, this court cannot agree with the plaintiffs that they have any ground to base their reliance upon the Caulkins decision and the acquiescence by the Commissioner. A thorough examination of the prior Treasury Department rulings demonstrates that the result reached in Caulkins was an exception to the general policy of the

Internal Revenue Service to treat amounts received by original issue discount as income. Also, the prior rulings demonstrate that Caulkins is distinguishable from the present claim on the law and on its facts.

In 1940, G. C. M. 21890, 1940-1 Cum. Bull. 85 was issued. There, the Commissioner held that the amount of an original issue discount upon a state obligation was in the nature of deferred interest, therefore, non-taxable income to the taxpayer under Section 22(b)(4) of the Revenue Act of 1938, which provided for the exclusion from gross income and exempted from taxation interest upon state obligations.

In 1941, I. T. 3486, 1941-2 Cum. Bull. 76 was published. It provided that since the Public Debt Act of 1941 provided that the interest upon, and gain from sale or other disposition of, United States Treasury Bills issued on or after March 1, 1941 are no longer tax exempt, the amount of discount "* * * is includible in gross income as interest * * *"

After Caulkins was affirmed by the Sixth Circuit, the Treasury Department acquiesced in its result. (See list of acquiescences in 1944 Cum. Bull.)

In 1953, the Commissioner published Rev. Rul. 119, 1953-2 Cum. Bull. 95. Rev. Ruling 119 provided:

> "What included in gross income
>
> "The discount at which a 'Twelve Year Dollar Savings Bond' of the State of Israel is originally issued constitutes interest which is taxable as ordinary income [fol. 13] under section 22(a) of the Internal Revenue Code when realized upon redemption; it does not represent an amount received upon retirement of the bond within the meaning of section 117(f) of the Code.
>
> * * * * * * * * *
>
> "Since about 1920, discount realized on retirement of State and municipal obligations in the hands of the original purchaser has been treated by the Bureau as interest, the theory being that the discount is an amount paid in lieu of interest. * * * The position taken by the Bureau * * * has been consistently maintained with regard to characterizing discount as interest and

treating the excess over discount (and ordinary interest, if any) realized upon retirement as taxable income. However, after the enactment of section 117(f) of the Internal Revenue Code, the excess over discount has been consistently taxed as capital gain rather than ordinary gain. (See G. C.M. 21890, C.B. 1940—1,85) Therefore, only the excess of the amount realized from a State or municipal bond, less discount from the date of acquisition, and ordinary interest, if any, over the cost or other basis of the bond is the amount received upon retirement taxable as capital gain under section 117(f) of the Code.

* * * * * * *

"In the case of Commissioner v. George Peck Caulkins, 144 Fed. (2d) 482, affirming Tax Court decision, 1 T.C. 656, acquiescence, C.B. 1944, 5, the Court held that the excess of the amount received by the taxpayer, pursuant to a contract with Investors Syndicate over the aggregate payments made by him for an Accumulative Installment Certificate, constituted capital gain and stated that the certificate in question '"was an [fol. 14] evidence of indebtedness" similar to a bond or debenture and hence falls within the statutory group governed by section 117(f).' This decision should be limited precisely to what was there decided under the particular facts of that case. It would be inappropriate to apply the decision to any other case unless the facts and circumstances conform to those stated in the published decision of the Tax Court in the Caulkins case."

In 1955, Revenue Ruling 55-136, 1955-1 Cum. Bull. 213 was published. It provided:

"Section 117(f) of the Internal Revenue Code of 1939 applies only to amounts received by reason of redemption of bonds. It does not apply to the amount of interest (whether paid in the form of discount or not) which is received by reason of holding the bond. Such interest-equivalent payments are taxable as ordinary income under section 22(a) of the Code.

* * * * * * *

"It has been the policy of the Internal Revenue Service to restrict the application of the Caulkins case to cases involving the identical facts. This position has been reconsidered in the light of Revenue Ruling 119, supra, i.e., that the amount received upon the redemption of a bond which represents original or initial discount constitutes interest which is taxable as ordinary income. There is no logical basis in fact or in law to distinguish the discount element in the Accumulative Installment Certificate involved in the Caulkins case from the original discount element involved ordinarily in the issuance of any bonds."

It is clear that Caulkins was an exception to the rule that amounts received from original issue discounts were treated as ordinary income. In order for the plaintiffs to [fol. 15] rely on Caulkins it is also clear that their claim must fall into the identical exception Caulkins created. Caulkins involved a peculiar application of Section 117(f), Internal Revenue Code of 1939, to redemption of "Accumulative Installment Certificates." Here, Section 117(f) does not apply since we have a sale before maturity and not a redemption. Therefore, the exception created by Caulkins is not precedent for the claim of plaintiffs.

In Midland-Ross Corp. v. United States, 214 F. Supp. 631 (N.D. Ohio 1963), cited by the plaintiffs, the court rejected the distinction between the tax consequences of a sale and that of a redemption. The court stated, 214 F. Supp. at 631: "The combination of the Caulkins case with Section 117(f) thus indicates that appreciation realized on evidences of indebtedness, issued at an original issue discount and sold before maturity, constituted a capital gain and not regular income. The remaining question, therefore, is whether the legislative, administrative and judicial treatments of discount obligations support this indication." The court concluded " * * * while it is true that the recent cases have adopted the Government's position, they have done so (1) without a discussion of the historical treatment of gains resulting from original issue discount, and (2) only upon a rejection of the Caulkins case, which is controlling in this Circuit."

I cannot agree with the court in Midland-Ross, supra, that the legislative, judicial and administrative treatments support the conclusion that increments by way of original issue discounts on bonds sold before maturity must be treated as capital gains. Moreover, the Caulkins case does not support the court's conclusion for two reasons. First, on its facts it was wrongly decided; second, assuming Caulkins was correct, it provides no precedent for cases concerning the sale before maturity of original issue discount bonds.

In sum, it is clear that (1) Caulkins was wrongly decided; (2) even assuming Caulkins had been correctly de-[fol. 16] cided, it proves no precedent for the plaintiffs; and (3) the plaintiffs cannot estop the government on the basis of the Caulkins acquiescence.

The plaintiffs' claim for refund is narrowed to a single question: What is the tax treatment accorded to increments received from short-term, non-interest bearing notes issued at a discount? The answer is clear; that portion of any profit realized upon a subsequent sale of the notes which is attributable to the discount as well as any discount earned upon unsold notes is taxable as ordinary income and not capital gain.

Substance, reality and total effect of a particular transaction will determine the tax consequences thereof. Commissioner v. P. G. Lake Inc., 356 U. S. 260, 266 (1957). The forms or method of accounting for a transaction do not control, since "Their essence is determined not by the subtleties of draftsmanship but by their total effect. See Helvering v. Clifford, 309 U. S. 331; Harrison v. Schaffner, 312 U. S. 579." 356 U. S. at 266-67. In other words: "The law is not to be hoodwinked by colorable pretenses. It looks at truth and reality, through whatever disguise it may assume." Commonwealth v. Hunt, 45 Mass. 111, 129 (1842).

The "total effect" of the transactions which the partnership entered into makes it clear that the partnership earned interest, ordinary income, as a result of these discounts. The term "interest," as contained in the "gross income" definition contained in Section 22(a), Int. Rev. Code of 1939, is defined as the amount which one has contracted

to pay for the use of borrowed money. Old Colony Railroad Co. v. Commissioner, 284 U. S. 552, 560 (1932); Commissioner v. Morgan, 272 F. 2d 936, 939 (9 Cir. 1939); Jaglom v. Commissioner, 303 F. 2d 847, 850 (2 Cir. 1962). Although it is true that there may be some valid distinctions between interest and discounts, these distinctions are of little significance. A discount is in the nature of deferred [fol. 17] interest which may be amortized, for income tax purposes, over the life of the bonds. The Internal Revenue Service in computing the plaintiffs' tax liability did properly accrue their interest ratably over the period it was earned. 2 Mertens, Law of Federal Income Taxation, § 12.95, p. 276 (Zimet Rev. 1958); Continental Tie & Lumber Co. v. United States, 286 U. S. 290 (1932); United States v. Anderson, 269 U. S. 422 (1926).

The plaintiffs contend that the enactment of Section 1232, Int. Rev. Code of 1954, which treats increments from discounts as ordinary income, did effect a change in the laws governing the tax treatment of original issue discounts. This contention is without merit. As stated in Commissioner v. Morgan, 272 F. 2d 936, 941 (9 Cir. 1959):

> "* * * Respondents argue that by making this new provision for bonds issued in the future, Congress recognized that it effected a change and thereby recognized that the law previously was settled by the Caulkins decision. We think not. The Senate Report which accompanied the legislation (S. Rep. No. 1622, 83d Cong., 2d Sess. p. 112; 3 U. S. C. Cong. & Adm. News 1954, 4621, 4745), noted that there was 'some uncertainty as to the status of proceeds in these transactions. * * * The House bill removes doubt in this area.' We find here no evidence that the new enactment did any more than that."

The plaintiffs also contend that even if the original issue discount is taxable as ordinary income, the Internal Revenue Service erroneously accrued the income from the notes not sold by the partnership during the taxable year 1952. While the plaintiffs concede the partnership was on the accrual basis, they assert that the notes were really individual

investments of the taxpayers and not the property of the partnership and, hence, interest may not be accrued since the partner taxpayers were on the cash basis. The taxpayers state that there is an issue of fact as to the method [fol. 18] of accounting utilized in these investments since they state they used a cash rather than accrual basis. Therefore, they contend that none of the proceeds from the notes that were not sold or redeemed in 1952 should be included in the computation of the 1952 income of the partners.

The claim for refund as well as the complaint filed herein (paragraph 17(e) and (f)) allege that the securities were partnership property. There is no doubt that the partnership tax return was computed on the accrual basis in 1952. Therefore, the unsupported allegation in plaintiffs' statement pursuant to Rule 9(g) of the General Rules of the United States District Court for the Southern District of New York to the effect there remains a genuine issue of fact as to the method of accounting will not prevent the grant of complete summary judgment to the government. As Rule 56, Fed. R. Civ. P. makes clear: "When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon mere allegations or denials of his pleadings, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial." This the plaintiffs have not done. Since this is a refund action the plaintiffs must not only demonstrate that the Commissioner's method of computation is wrong but also must establish the actual and precise method of computation which should have been utilized. Taylo v. Commissioner, 70 F. 2d 619, 620-21 (2 Cir.), aff'd 293 U. S. 507 (1935); Alvary v. United States, 302 F. 2d 90 (2 Cir. 1962).

Accordingly, the plaintiff's motion for summary judgment is denied and the defendant's motion for summary judgment is granted with costs.

Settle judgment on notice.

Dated: New York, N. Y., November 1, 1963.

Richard H. Levet, United States District Judge.

[fol. 19]

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

AMENDED COMPLAINT

1. Plaintiffs bring this action against the United States for the recovery of income taxes illegally and erroneously assessed and collected from them. The plaintiffs, other than plaintiff Hubert R. A. Simon, are citizens of the United States and reside in the United States Judicial District known as the Southern District of New York. Plaintiff Hubert R. A. Simon is a citizen of Great Britain. Jurisdiction is conferred upon this Court by 28 U. S. C. Section 1346(a).

2. Plaintiffs W. Palmer Dixon and Joan Dixon at all times during the year 1952 were and still are husband and wife.

3. Plaintiffs Everett W. Cady and Clarissa H. Cady at all times during the year 1952 were and still are husband and wife.

4. On or about the 2nd day of December, 1956, the above-named Frank E. Gernon died leaving a Last Will and Testament which was thereafter and on the 28th day of December, 1956 duly admitted to probate by the Surrogate's Court of the County of Westchester, and letters testamentary thereof were duly issued by said Court to plaintiffs Helen J. Gernon and Helene J. Hirson on the [fol. 20] 28th day of December, 1956 and they thereupon duly qualified and thereafter acted and are still acting as such Executrices.

5. Plaintiff Helen J. Gernon is the widow of Frank E. Gernon, deceased.

6. Plaintiffs J. Herbert Higgins and Marion Blair Higgins at all times during the year 1952 were and still are husband and wife.

7. Plaintiffs Stephen A. Koshland and Carol F. Koshland are husband and wife.

8. On or about the 3rd day of January, 1955, the above-named Carl M. Loeb, Sr. died leaving a Last Will and Testament which was thereafter and on the 14th day of January, 1955 duly admitted to probate by the Surrogate's Court of the County of New York and letters testamentary thereof were duly issued by said Court to plaintiffs Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr. and Margaret L. Kempner on the 14th day of January, 1955 and they thereupon duly qualified and thereafter acted and are still acting as such Executors.

9. On or about the 28th day of November, 1953 the above-named Adeline M. Loeb died leaving a Last Will and Testament and Codicil thereto which were thereafter and on the 14th day of December, 1953 and on the 16th day of February, 1954 respectively, duly admitted to probate by the Surrogate's Court of the County of New York and letters testamentary thereof were duly issued by said Court to plaintiffs Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr. and Alan H. Kempner on the 14th day of December, [fol. 21] 1953 and they thereupon duly qualified and thereafter acted and are still acting as such Executors.

10. Plaintiffs John L. Loeb and Frances L. Loeb at all times during the year 1952 were and still are husband and wife.

11. Plaintiffs Henry A. Loeb and Louise S. Loeb at all times during the year 1952 were and still are husband and wife.

12. Plaintiffs Clifford W. Michel and Barbara R. Michel at all times during the year 1952 were and still are husband and wife.

13. Plaintiffs Mark J. Millard and Claire Millard at all times during the year 1952 were and still are husband and wife.

14. Plaintiffs Henry Parish, 2nd and Dorothy Parish at all times during the year 1952 were and still are husband and wife.

15. Plaintiffs Samuel L. Stedman and Gerda C. Stedman at all times during the year 1952 were and still are husband and wife.

16. Plaintiffs' claims are for the recovery of United States income taxes in the principal amount of $369,329.65 illegally and erroneously assessed and collected from them and/or their decedents for the calendar year 1952 together with interest thereon, as follows:

[fol. 22]

Plaintiffs	*Principal Amount of Income Tax*
W. Palmer Dixon and Joan Dixon	$ 18,874.12
Everett W. Cady and Clarissa H. Cady	10,870.08
Helen J. Gernon and Helene G. Hirson, as Executrices of the Last Will and Testament of Frank J. Gernon, deceased, and Helen J. Gernon	9,135.82
J. Herbert Higgins and Marion Blair Higgins	1,119.08
Stephen A. Koshland and Carol F. Koshland	4,570.96
Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr., and Margaret L. Kempner as Executors of the Last Will and Testament of Carl M. Loeb, Sr., deceased, and Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr. and Alan H. Kempner as Executors of the Last Will and Testament of Adeline M. Loeb, deceased	140,248.59
John L. Loeb and Frances L. Loeb	86,467.14
Henry A. Loeb and Louise S. Loeb	26,318.31
Clifford W. Michel and Barbara R. Michel	39,111.02

Plaintiffs	*Principal Amount of Income Tax*
Mark J. Millard and Claire Millard	18,022.74
Henry A. Parish, 2nd and Dorothy Parish	3,222.64
Hubert R. A. Simon	6,243.43
Samuel L. Stedman and Gerda C. Stedman	5,125.72

17. The facts upon which said claims are based are as follows:

[fol. 23] (a) During the year 1952 Armand G. Erpf, Samuel L. Hornstein, Frederick T. Koyle, A. Raymond McKernan and Hans A. Widenmann and plaintiffs W. Palmer Dixon, Everett W. Cady, J. Herbert Higgins, Stephen A. Koshland, John L. Loeb, Henry A. Loeb, Clifford W. Michel, Mark J. Millard, Henry Parish, 2nd, Hubert R. A. Simon, Samuel L. Stedman, Theodore Bernstein, Frank E. Gernon, Carl M. Loeb, Sr. and Adeline M. Loeb (hereinafter collectively referred to as the "Partners") were co-partners doing business under the firm name and style of Carl M. Loeb, Rhoades & Co. (hereinafter referred to as the "Partnership").

(b) From time to time during the year 1952 the Partnership acquired certain promissory notes (hereinafter referred to as "Commercial Paper") which had been issued at a discount. Some of the Commercial Paper was acquired from the issuer thereof; in most instances the Commercial Paper was acquired from a dealer.

(c) None of the Commercial Paper was issued by the United States or any possession thereof, nor by any State or territory or any political subdivision thereof, nor by the District of Columbia.

(d) Immediately following the acquisition of the Commercial Paper as aforesaid, the Commercial Paper was

clearly identified on the records of the Partnership as being held for investment purposes and was physically segregated from non-investment securities held by the Partnership in accordance with Section 117(a) of the Internal Revenue Code of 1939.

(e) From time to time during the year 1952, the Partnership sold portions of its investment holdings in the Commercial Paper prior to the maturity thereof. All of the Commercial Paper thus sold had been held for a period in excess of six months. In no instance was any sale made [fol. 24] to the issuer of the Commercial Paper in question. In entering into the transactions of acquisition alleged in subparagraph (b) of this paragraph and the transactions of sale alleged in this subparagraph (e), plaintiffs relied upon the case of *Caulkins* v. *Commissioner*, 1 T. C. 656 (1943), affirmed 144 F. 2d 482 (C. A. 6th, 1944), and on the Commissioner's acquiescence therein, as requiring the tax consequence that the profits on the sales would be capital gains.

(f) The partnership reported the difference between the sales prices of the Commercial Paper and the cost of the same to the Partnership as gain from the sale of capital assets held for a period in excess of six months and accordingly as long-term capital gain, and the Partners reported their respective distributive shares of said long-term capital gain and paid the tax thereon accordingly. The Commissioner of Internal Revenue sent statutory notices of deficiency in income taxes to the plaintiffs on the ground that the difference between the adjusted basis to the Partnership of the Commercial Paper and the sales price thereof constituted ordinary income in the nature of interest, and on the further ground that a pro rata portion of the difference between the adjusted basis of the Commercial Paper still held by the Partnership at the end of the calendar year 1952 and the face value at maturity of such Commercial Paper constituted accrued interest earned and was therefore includible as interest in the ordinary

income of the Partnership for that year, and taxable to the Partners to the extent of their distributable shares thereof.

(g) On the basis of the foregoing determinations, the aforementioned statutory notices of deficiency increased the distributable shares of Partnership ordinary income on the plaintiffs' returns for the year 1952 and reduced the distributable shares of net Partnership long-term capital gain reported on said return as follows:

[fol. 25]

Plaintiffs	*Increase in Ordinary Income*	*Decrease in Net Long-Term Capital Gain (50%)*
W. Palmer Dixon and Joan Dixon	$ 38,441.23	$ 12,357.28
Everett W. Cady and Clarissa H. Cady	23,064.74	7,414.37
Helen J. Gernon and Helene G. Hirson, as Executrices of the Last Will and Testament of Frank J. Gernon, deceased, and Helen J. Gernon	23,064.74	7,414.37
J Herbert Higgins and Marion Blair Higgins	5,766.19	1,853.59
Stephen A. Koshland and Carol F. Koshland	15,376.49	4,942.92
Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr., and Margaret L. Kempner as Executors of the Last Will and Testament of Carl M. Loeb, Sr., deceased, and Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr., and Alan H. Kempner as Executors of the Last Will and Testament of Adeline M. Loeb, deceased	215,270.92	69,200.78

Plaintiffs	*Increase in Ordinary Income*	*Decrease in Net Long-Term Capital Gain (50%)*
John L. Loeb and Frances L. Loeb	138,388.45	44,486.22
Henry A. Loeb and Louise S. Loeb	38,441.23	12,357.28
[fol. 26] Clifford W. Michel and Barbara R. Michel	61,505.97	19,771.65
Mark J. Millard and Claire Millard	38,441.23	12,357.28
Henry Parish, 2nd and Dorothy Parish	7,688.25	2,471.46
Hubert R. A. Simon	14,714.77	4,942.92
Samuel L. Stedman and Gerda C. Stedman	15,376.49	4,942.91

18. (a) As a result of the foregoing adjustments, the District Director of Internal Revenue, Lower Manhattan, erroneously assessed and between on or about April 25, 1957 and on or about May 2, 1957, collected additional income taxes from the plaintiffs in the amounts set forth in paragraph 16 above.

(b) On December 20, 1957 the plaintiffs duly filed with the District Director of Internal Revenue, Lower Manhattan, in accordance with the provisions of law in that regard and the regulations of the Secretary of the Treasury in pursuance thereof, claims for refund of the amounts set forth in paragraph 16 above which had been erroneously assessed and paid under protest to the District Director of Internal Revenue, Lower Manhattan, as aforesaid. Copies of such claims for refund are annexed hereto, made a part hereof, and marked Exhibits A to M, inclusive. The In-

ternal Revenue Service was apprised, in the course of its consideration of these said claims for refund, that one of the arguments of the taxpayers in support of said claims [fol. 27] was that in entering into the transactions of acquisition alleged in subparagraph (b) of paragraph 17 hereof and the transactions of sale alleged in subparagraph (c) of paragraph 17 hereof, plaintiffs relied upon the case of *Caulkins* v. *Commissioner*, 1 T. C. 656 (1943), affirmed 144 F. 2d 482 (C. A. 6th, 1944), and on the Commissioner's acquiescence therein, as requiring the tax consequence that the profits on the sales would be capital gains.

(c) More than six months have expired since the filing of the aforesaid claims for refund on December 20, 1957 and the commencement of this suit, and less than two years have elapsed from the denial thereof.

(d) No part of the income taxes in the amounts set forth in paragraph 16 hereof, together with interest thereon, as overpaid by plaintiffs have been refunded to the plaintiffs.

19. By virtue of the foregoing, defendant became and now is indebted to the plaintiffs in the respective amounts set forth in paragraph 16 hereof, together with interest as provided by law.

Wherefore, the plaintiffs now claim judgment against defendant as follows:

A. In favor of W. Palmer Dixon and Joan Dixon the amount of $18,874.12, together with interest thereon as allowed by law;

B. In favor of plaintiffs Everett W. Cady and Clarissa H. Cady in the amount of $10,870.08, together with interest thereon as allowed by law;

C. In favor of plaintiffs Helen J. Gernon and Helene G. Hirson, as Executrices of the Last Will and Testament of Frank E. Gernon, deceased, and Helen J. Gernon in the [fol. 28] amount of $9,135.82 together with interest thereon as allowed by law;

D. In favor of plaintiffs J. Herbert Higgins and Marion Blair Higgins in the amount of $1,119.08 together with interest thereon as allowed by law;

E. In favor of plaintiffs Stephen A. Koshland and Carol F. Koshland in the amount of $4,570.96, together with interest thereon as allowed by law;

F. In favor of plaintiffs Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr. and Margaret L. Kempner, as Executors of the Last Will and Testament of Carl M. Loeb, Sr. and in favor of plaintiffs Henry A. Loeb, John L. Loeb, Carl M. Loeb, Jr. and Alan H. Kempner, as Executors of the Last Will and Testament of Adeline M. Loeb in the amount of $140,248.69 together with interest thereon as allowed by law;

G. In favor of plaintiffs John L. Loeb and Frances L. Loeb in the amount of $86,467.14 together with interest thereon as allowed by law;

H. In favor of plaintiffs Henry A. Loeb and Louise S. Loeb, in the amount of $26,318.31 together with interest thereon as allowed by law;

I. In favor of plaintiffs Clifford W. Michel and Barbara R. Michel in the amount of $39,111.02 together with interest thereon as allowed by law;

J. In favor of plaintiffs Mark J. Millard and Claire Millard in the amount of $18,022.74 together with interest thereon as allowed by law;

K. In favor of plaintiffs Henry Parish, 2nd and Dorothy Parish in the amount of $3,222.64 together with interest thereon as allowed by law;

[fol. 29] L. In favor of plaintiff Hubert R. A. Simon in the amount of $6,243.43 together with interest thereon as allowed by law;

M. In favor of plaintiffs Samuel L. Stedman and Gerda C. Stedman in the amount of $5,125.72 together with interest thereon as allowed by law;

together with costs and such other relief as may to this honorable Court seem just and proper.

Stroock & Stroock & Lavan, By: Bernard E. Brandes, A Member of the Firm, Attorneys for Plaintiffs.

(Copies of the refund claims annexed as exhibits A through M of the Amended Complaint have been omitted.)

[fol. 30]

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

ANSWER

Now comes the above-named defendant, by its attorney, S. Hazard Gillespie, Jr., United States Attorney in and for the Southern District of New York, and for its answer to the complaint filed herein alleges as follows:

I.

Admits the allegations contained in the first sentence of paragraph 1 thereof, except that it is denied that the taxes sought to be recovered were illegally and erroneously assessed and collected from plaintiffs. Admits the allegations contained in the second sentence of said paragraph, except that the defendant is presently without knowledge or information sufficient to form a belief as to the truth of the allegation that plaintiff Hubert R. A. Simon is a citizen of Great Britain. Admits the allegations contained in the third sentence of said paragraph.

II. through XV.

The defendant is presently without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs numbered 2 through 15 thereof.

XVI.

Admits the allegations contained in paragraph numbered 16 thereof, except that it is denied that the additional income [fol. 31] taxes for the calendar year 1952, together with interest thereon, referred to in said paragraph, were illegally and erroneously assessed and collected from plaintiffs and/or their decedents, as alleged in said paragraph.

XVII.

Admits the allegations contained in subparagraph (a) of paragraph 17 thereof. The defendant is presently without knowledge or information sufficient to form a belief as to the truth of all of the allegations contained in subparagraphs (b) through (f) thereof. Admits the allegations contained in subparagraph (g) thereof.

XVIII.

Denies the allegations contained in subparagraph (a) of paragraph 18 thereof, except that it is admitted that the additional income taxes assessed against plaintiffs as a result of the adjustments referred to in subparagraph (g) of paragraph 17 thereof and as set forth in paragraph 16 of the complaint were paid on or about the dates alleged in said subparagraph. Denies the allegations contained in the first sentence of subparagraph (b) of paragraph 18, except that the defendant admits that claims for refund of the amounts set forth in paragraph 16 of the complaint were filed with the District Director of Internal Revenue, Lower Manhattan, on December 20, 1957. For answer to the second sentence of subparagraph (b) of paragraph 18 thereof, the defendant denies each and every allegation contained in said claims for refund, copies of which are annexed to the complaint as Exhibits A to M, inclusive. Admits the allegations contained in subparagraph (c) of paragraph numbered 18 thereof. Admits the allegations contained in subparagraph (d) of paragraph 18 thereof, except it is denied that there was any overpayment by plaintiffs of taxes or interest sought to be recovered in this action.

[fol. 32] XIX.

Denies the allegations contained in paragraph numbered 19 thereof.

Wherefore, defendant prays that the complaint filed herein be dismissed, with costs to be assessed against the plaintiff.

S. Hazard Gillespie, Jr., United States Attorney for the Southern District of New York, Attorney for Defendant, by Stephen Kurzman, Assistant United States Attorney.

[fol. 33]

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

DEFENDANT'S NOTICE OF MOTION FOR SUMMARY JUDGMENT—May 27, 1963

Sirs:

Please Take Notice that upon the annexed statement pursuant to Rule 9(g) and memorandum of law, and upon all papers and proceedings heretofore had or filed herein, the defendant, United States of America, will move this Court, at a term for motions, in Room 506, U. S. Courthouse, Foley Square, New York, N. Y., on June 11, 1963, at 10:00 o'clock in the forenoon or as soon thereafter as counsel may be heard, for summary judgment, pursuant to Rule 56 of the Federal Rules of Civil Procedure, dismissing the complaint with prejudice and with costs.

Dated: New York, N. Y., May 27, 1963.

Yours, etc.,

Robert M. Morgenthau, United States Attorney for the Southern District of New York, Attorney for Defendant.

[fol. 34] To: Stroock & Stroock & Lavan, Esqs., Attorneys for Plaintiffs, 61 Broadway, New York 6, N. Y.

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

DEFENDANT'S STATEMENT PURSUANT TO RULE 9(G), READ IN SUPPORT OF DEFENDANT'S MOTION FOR SUMMARY JUDGMENT—May 27, 1963

1. This Court has jurisdiction over this action for the refund of taxes for the taxable year, 1952, pursuant to 28 U. S. C. 1346(a).

2. During the year 1952 plaintiffs herein were members of the partnership known as Carl M. Loeb, Rhoades & Co. (hereinafter termed "the partnership").

3. Plaintiffs, as partners of said partnership, were engaged in the business of dealing as agents for customers in securities and commodities transactions, the underwriting and selling of securities, and trading and investing for the account of the firm.

4. The firm's books and records were regularly kept on the accrual basis of accounting and its tax returns were filed on the accrual basis. Plaintiffs are thus required to report their distributive share of the partnership's income as computed upon the accrual basis.

5. During the year 1952 the partnership acquired thirty-three (33) ordinary short-term promissory notes, com- [fol. 35] monly known as "commercial paper," in the total face amount of $43,050,000, consisting of $34,000,000 worth of said notes in United States dollars and $9,050,000 worth of same in Canadian dollars. A schedule indicating the obligor corporations which issued the notes, the dates and prices of their purchase and sale by the partnership, their face value, and the profit realized upon sale is hereto annexed as Schedule "A".

6. Said promissory notes were purchased by the partnership on the original dates of issue in all but one in-

stance, either directly from the respective corporations which issued the notes or through agents thereof or dealers.

7. Said promissory notes bore maturity dates from 190 to 272 days from the dates of issue.

8. No provision was made by the terms of any of said promissory notes for the payment of any interest.

9. Said promissory notes were issued at a discount ranging from 2⅜ to 3¾ per cent of face value and the partnership paid for each of the notes this exact discounted price for which the notes were originally issued. The total purchase price for the notes was $42,222,357.21, consisting of $33,374,235.39 in United States Dollars and $8,848,121.82 in Canadian dollars. (See Schedule "A").

10. The notes were segregated and identified as being held for investment in accordance with Section 117(n) of the Internal Revenue Code of 1939.

11. Upon purchase, these notes would be used as collateral to secure loans equal to the face value thereof from various bankers. The total interest paid on such loans in the sum of $624,000.54 was claimed as a deduction upon plaintiffs' tax returns for the year herein in issue.

[fol. 36] 12. During the year 1952, prior to the respective dates of maturity of the notes and after holding said notes for more than 6 months, the partnership sold twenty of the notes for which it had paid $26,501,534.00 for the sum of $26,996,062.68, thereby realizing a profit in the sum of $494,528.68. (See Schedule "A"). In its income tax returns for the year 1952 the partnership reported said difference between the sales price of said notes and the cost to the partnership, or $494,528.68, as gain from the sale of capital assets held for the period in excess of 6 months, ("long term capital gain") and the partners (the plaintiffs herein) reported their respective distributive shares of said gain and paid the tax thereon accordingly.

13. The Commissioner of Internal Revenue duly assessed income tax deficiencies against plaintiffs upon the following grounds:

a. That the amount of the discount which was earned during the taxable year 1952 by the plaintiffs constituted ordinary income and not capital gain;

b. That said amount of discount constitutes the difference between the face value of the notes and the lesser amounts paid therefor by the partnership, and,

c. That said difference, divided by the number of days between issue date and maturity date, results in the amount of discount earned each day the notes were held by the partnership (See next to last column of Schedule "A"), and

d. That the amount of discount earned per day multiplied by the number of days the notes were held during 1952 constitutes ordinary income to plaintiffs and not capital gain as they had reported it on their returns; in the case of the notes which were sold prior to the close of 1952, said "earned discount" (See Schedule "A") exceeded the profit realized in each instance save one (the Industrial [fol. 37] Acceptance Corp. Ltd. note) so that the entire aforesaid profit of $494,528.68 upon sale of the notes constituted ordinary income and not capital gain, except for the sum of $924.94, representing the excess of the profit over the earned discount and which did constitute capital gain in the sole aforementioned instance;

e. That as to the notes which were not sold during 1952, the amount of the discount earned per day multiplied by the number of days the notes were held until the close of the year constituted ordinary income to plaintiffs, since the partnership was on the accrual basis of accounting.

f. All of which resulted in adjustments decreasing plaintiffs' capital gain and increasing their ordinary income as is fully set forth in Paragraph 17(g) of the complaint herein, and corresponding deficiencies in tax, as is set forth in Paragraph 16 of the complaint herein, of which plaintiffs were duly notified by notices of deficiencies.

14. Plaintiffs paid said deficiencies, filed timely claims for refund, and commenced this action for the recovery thereof.

Dated: New York, N. Y., May 27, 1963.

Yours, etc.,

Robert M. Morgenthau, United States Attorney for the Southern District of New York, Attorney for United States of America.

(Schedule A annexed to Defendant's Statement Pursuant to Rule 9(g) has been omitted.)

[fol. 38]

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

PLAINTIFFS' NOTICE OF CROSS-MOTION FOR SUMMARY JUDGMENT—August 23, 1963

Sir:

Please Take Notice that upon the annexed statement pursuant to Rule 9(g) and Plaintiffs' memorandum of law, and upon the statement pursuant to Rule 9(g) filed in support of Defendant's motion for summary judgment, and upon all papers and proceedings heretofore had or filed herein, the Plaintiffs will move this Court, at a Term for motions, in Room 506, U. S. Courthouse, Foley Square, New York, N. Y., on the 10th day of September, 1963, at 10:00 A. M., or as soon thereafter as counsel may be heard, for summary judgment, pursuant to Rule 56 of the Federal Rules of Civil Procedure, with costs.

Dated: New York, New York, August 23, 1963.

Yours, etc.,

Stroock & Stroock & Lavan, Esqs., Attorneys for Plaintiffs.

To: Hon. Robert M. Morgenthau, United States Attorney for the Southern District of New York, Attorney for Defendant.

[fol. 39]

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

PLAINTIFFS' STATEMENT PURSUANT TO RULE 9(g) ON DEFENDANT'S MOTION AND ON PLAINTIFFS' CROSS-MOTION—August 23, 1963

I.

Plaintiffs admit that the paragraphs of Defendant's statement pursuant to Rule 9(g) state material facts as to which no genuine issue exists except as to paragraph 4, which states facts as to which a genuine issue remains to be tried.

II.

In support of Plaintiffs' cross-motion for summary judgment, and in opposition to Defendant's motion, Plaintiffs contend that additional facts as to which no genuine issue remains to be tried are as follows:

1. The books and records of Carl M. Loeb, Rhoades & Co. ("the partnership") in connection with its brokerage and general business activities are kept on the accrual basis of accounting. During the taxable year here involved, as well as many years prior thereto, the partnership's books and records in connection with its activities for its own account, such as the buying and selling of securities as principal, were kept on the cash basis. The tax returns of the partnership reflect the methods of bookkeeping thus employed.

[fol. 40] 2. The securities referred to as "commercial paper" which are the securities involved in the within action were purchased by the partnership as principal for its own account as a partnership investment. During the taxable year here involved, as well as for many years prior thereto, the accounting as well as the reporting for tax purposes in connection with partnership investments was on a cash basis.

3. In Office Decision 1024, 1920 Cum. Bull. 189, the Commissioner of Internal Revenue ruled that original issue discount is not taxable interest.

4. Legislative history in connection with Revenue legislation prior to the Internal Revenue Code of 1954 demonstrates the Treasury Department position that original issue discount is not interest.

5. On December 25, 1944, the Commissioner of Internal Revenue published his Acquiescence in the case of *Caulkins v. Commissioner*, 1 T. C. 656, *aff'd* 144 F. 2d 482 (C. A. 6th, 1944).

6. On March 12, 1952 the Commissioner of Internal Revenue issued a special ruling published in 525 CCH Standard Federal Tax Reporter, Para. 6161, which held that no withholding for income tax purposes was required as regards original issue discount realized by non-resident aliens (which withholding would have been required had original issue discount been the equivalent of interest) and that such original issue discount was taxable as capital gain when realized, as to which gain a non-resident alien could have a United States tax liability only under the limited circumstances set forth in the Internal Revenue Code with regard to capital gains realized by nonresident aliens.

[fol. 41] 7. Consistently with the position of the Treasury Department, as demonstrated by the aforementioned Office Decision, Acquiescence and Special Ruling, and in other respects as hereinabove set forth, the gain realized by the partnership upon the sale of the securities here involved was capital gain and the Defendant's representatives should have held consistently that original issue discount was not interest to be accrued ratably as earned.

8. All of the securities (commercial paper) here involved were purchased by the partnership prior to July 6, 1953.

9. The partnership, when purchasing such securities, was aware of the then position of the Internal Revenue

Service as hereinabove set forth, and made such purchases in reliance thereon.

10. No published doubt existed with regard to the position of the Internal Revenue Service until July 6, 1953, when there was published Revenue Ruling 119, 1953-2 Cum. Bull. 95, in which it is stated that the decision in the *Caulkins* case and the Acquiescence therein should be limited strictly to what was therein decided.

11. On March 11, 1955 the Commissioner of Internal Revenue withdrew his Acquiescence in the *Caulkins* case, and on June 25, 1956, in Revenue Ruling 56-299, 1956-1 Cum. Bull. 603, amplified his position by ruling that no basis existed for differentiating the debt instrument in the *Caulkins* case from other debt instruments issued at a discount, that in all cases original issue discount was the equivalent of interest, but that no retroactive effect would be given this change of position except as to the type of debt instrument of the particular issuer, as involved in the *Caulkins* case, provided such securities were purchased dur-[fol. 42] ing the period December 25, 1944, the date the Acquiescence in the *Caulkins* case was announced, and December 31, 1954.

12. If the change of position by the Treasury Department is sustained and made applicable to the partnership, the latter and its partners, including the Plaintiffs herein, will sustain injury therefrom.

13. The partnership would not have made this type of investment had the position of the Treasury Department been otherwise.

14. In limiting the retroactive effect of Revenue Ruling 56-299, *supra*, to the specified securities of a specified issuer, the Commissioner of Internal Revenue abused the discretion given him in Section 3791(b) of the Internal Revenue Code of 1939.

Dated: New York, New York, August 23, 1963.

Yours, etc.,

Stroock & Stroock & Lavan, Attorneys for Plaintiffs.

[fol. 43]

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

PLAINTIFFS' SUPPLEMENTAL STATEMENT PURSUANT TO RULE 9(G) ON DEFENDANT'S MOTION AND ON PLAINTIFFS' CROSS-MOTION—October 4, 1963

15. The investigation by the Treasury Department of the merits of the claims for refund would have apprised the defendant that the partnership and its partners, including the plaintiffs herein purchased such securities (the commercial paper here involved) in reliance upon the position of the Internal Revenue Service as demonstrated by the acquiescence in the *Caulkins* decision and upon the interpretation of the Internal Revenue Code made in the *Caulkins* case as acquiesced.

16. That the partnership relied upon the aforementioned position of the Treasury Department in making the investment hereinabove referred to was known to the Treasury Department and therefore to defendant.

Dated: New York, New York, October 4, 1963.

Yours, etc.,

Stroock & Stroock & Lavan, Attorneys for Plaintiffs.

[fol. 44] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
Docket No. 28752

W. PALMER DIXON, JOAN DIXON, EVERETT W. CADY, CLARISSA H. CADY, J. HERBERT HIGGINS, MARION BLAIR HIGGINS, STEPHEN A. KOSHLAND, HENRY A. LOEB, JOHN L. LOEB, CARL M. LOEB, JR. and MARGARET L. KEMPNER, as Executors of the Last Will and Testament of CARL M. LOEB, SR., Deceased, HENRY A. LOEB, JOHN L. LOEB, CARL M. LOEB, JR., and ALAN H. KEMPNER, as Executors of the Last Will and Testament of ADELINE M. LOEB, Deceased, JOHN L. LOEB, FRANCES L. LOEB, HENRY A. LOEB, LOUISE S. LOEB, CLIFFORD W. MICHEL, BARBARA R. MICHEL, MARK J. MILLARD, CLAIRE MILLARD, HENRY PARISH 2ND, DOROTHY PARISH, HUBERT R. A. SIMON, SAMUEL L. STEDMAN and GERDA C. STEDMAN, Plaintiffs-Appellants,

HELEN J. GERNON and HELENE G. HIRSON, as Executrices of the Last Will and Testament of FRANK E. GERNON, Deceased, HELEN J. GERNON, Plaintiffs,

—against—

THE UNITED STATES OF AMERICA, Defendant-Appellee.

APPENDIX FOR THE UNITED STATES OF AMERICA—
Filed April 16, 1964

[fol. 45]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
60 Civ. 2134

W. PALMER DIXON, *et al.*, Plaintiffs,

v.

UNITED STATES OF AMERICA, Defendant.

AFFIDAVIT IN SUPPORT OF DEFENDANT'S MOTION FOR SUMMARY JUDGMENT—Sworn to September 27, 1963

State of New York,
County of New York,
Southern District of New York—ss.:

Robert Arum, being duly sworn, deposes and says:

1. I am an Assistant United States Attorney in the office of Robert M. Morgenthau, United States Attorney for the Southern District of New York, and as such I am in charge of and fully familiar with the above-entitled action.

2. In accordance with the usual procedure in tax refund cases, the Internal Revenue Service, after an action [fol. 46] has been commenced by a taxpayer, forwards its files pertaining to the matters raised in the litigation to the Department of Justice. These files are then placed in the custody of the attorney handling the case. Accordingly, as the attorney in charge of this litigation, I presently have custody of the files of the Internal Revenue Service relating to the matters raised by the taxpayers in this litigation.

3. As is set forth in paragraph 17(a), the plaintiffs named therein were partners in the firm of Carl M. Loeb, Rhoades & Co. ("the Partnership"). The books and records of the partnership were regularly kept on the ac-

crual basis of accounting and the tax returns were prepared by the partnership on the accrual basis. A photostatic copy of the partnership tax return for the year 1952 which was filed by the partnership on March 16, 1953 is attached as Exhibit A. The distributive share of each of the partners in the income and expense of the partnership, as computed on the accrual basis, is set forth on a schedule attached to the said tax return. As further appears from the said tax return, the securities involved in this litigation were reported on the said return as an asset of the partnership and the distributive share of each of the partners in the results of the transactions relating to the securities was reported on the said tax return.

4. In 1956 when the District Director first proposed to assess deficiencies with respect to the treatment by Carl M. Loeb, Rhoades & Co. ("the partnership") of the securi- [fol. 47] ties transactions here in question, the partners were afforded an opportunity in accordance with the usual practice of the Internal Revenue Service, to protest against the proposed deficiencies. Henry A. Loeb, a general partner in the partnership, filed a protest, under oath, on behalf of himself and the other persons who were partners in the partnership during the calendar year 1952. A copy of the said protest, which was signed under oath by Mr. Loeb, is attached hereto as Exhibit B. In the protest Mr. Loeb set forth the facts upon which the objections to the proposed deficiencies were based. Mr. Loeb alleged that the securities constituted holdings of the partnership and were capital assets in the hands of the partnership. At no place in the statement of facts upon which the protest was based or anywhere else in the aforesaid protest did Mr. Loeb maintain that the partnership had purchased the securities in question in reliance on the acquiescence by the Commissioner in the *Caulkins* case or on other administrative determination.

5. Prior to the commencement of the above-entitled action, the District Director, in accordance with the provisions of §3772(a)(2) of the 1939 Code, gave notice to all of the plaintiffs, by registered mail, of the disallowance

in full of their claims for refund for the year 1952, upon which this litigation is based.

Wherefore, your deponent respectfully prays that the Court grant the motion of the defendant, United States of America, for summary judgment; deny plaintiffs' cross-motion for summary judgment; dismiss plaintiffs' com-[fol. 48] plaint with prejudice; award the United States the costs of this action; and grant to the United States such other and further relief as to the Court may seem just and proper.

Robert Arum, Assistant U. S. Attorney.

IN UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

AFFIDAVIT IN OPPOSITION TO PLAINTIFFS' MOTION FOR LEAVE TO AMEND COMPLAINT AND IN SUPPORT OF THE DEFENDANT'S MOTION FOR SUMMARY JUDGMENT—Sworn to October 14, 1963

State of New York,
County of New York,
Southern District of New York—ss.:

Robert Arum, being duly sworn, deposes and says:

1. I am an Assistant United States Attorney in the office of Robert M. Morgenthau, United States Attorney for the Southern District of New York, and as such I am in charge of and fully familiar with the above-entitled action.

[fol. 49] 2. This affidavit, which is supplementary to my previous affidavit dated September 27, 1963, heretofore filed with this Court, is made in opposition to the plaintiffs' motion to amend its complaint and in support of the Government's motion for summary judgment.

3. With respect to the Government's legal argument in opposition to the motion to amend the complaint, we

respectfully refer to the Point II of the Government's reply brief heretofore filed with this Court.

4. This affidavit is designed to furnish this Court with certain information in the files of the Government which contradicts various statements and assertions made in the affidavit of Bernard E. Brandes, sworn to on October 10, 1963, and served October 11, 1963 on the United States Attorney's Office.

5. As stated in paragraph 2 of my affidavit of September 27, 1963, I presently have custody of the files of the Internal Revenue Service relating to the matters raised by the taxpayers in this litigation.

6. In paragraph 5 of his affidavit of October 10, 1963, Mr. Brandes states that he pointed out to the Agent who audited the partnership return that the partnership had purchased the securities on the strength of the acquiescence in the *Caulkins* case and in reliance on it. The internal report of Revenue Agent Frank Amari, who audited the partnership return for the year 1952, does not make [fol. 50] reference in any way to the reliance issue. A copy of this internal report of Agent Amari is attached to this affidavit as Exhibit 1. Although Mr. Brandes states in paragraph 5 of his affidavit that he discussed the reliance question with the Agent on the audit of the partnership return, the report of Agent Amari shows that the discussions were had only with Mr. Laufer, a C.P.A., and a Mr. M. Barash, the Office Manager of the partnership. Furthermore, Mr. Amari has informed your deponent that at no time did the plaintiffs or any of their representatives, including Mr. Brandes, tell him that the partnership had acquired the securities in reliance on the *Caulkins* acquiescence. The Government is prepared, if necessary, to submit Mr. Amari's affidavit on this point.

7. In paragraph 6 of his affidavit, Mr. Brandes states that he participated in a meeting with Mr. Amari's supervisor to take up the questions arising as the result of the audit. Mr. Brandes states that he made statements to the supervisor that the partnership had purchased the securities in reliance on the Commissioner's acquiescence

in the *Caulkins* case. The meeting referred to by Mr. Brandes in paragraph 6 of his affidavit is called in the Revenue Service an "Informal Conference." A copy of the report prepared by Mr. Amari's Group Supervisor with respect to this conference is attached to this affidavit as Exhibit 2. There is absolutely no reference in this report to the reliance question which the plaintiffs seek to raise here in their amended complaint.

[fol. 51] 8. Thereafter, as stated in paragraph 4 of my affidavit of September 27, 1963, the District Director sent to the plaintiffs notices of proposed deficiencies. In accordance with the usual procedure, the plaintiffs filed a protest to the proposed deficiencies. The protest filed by the partnership on behalf of the plaintiffs was annexed as Exhibit B to my affidavit of September 27, 1963. At no place in such protest did the plaintiffs maintain that the partnership had purchased the securities in question in reliance on the acquiescence by the Commissioner in the *Caulkins* case, or on any other administrative determination.

9. In paragraph 7 of his affidavit, Mr. Brandes refers to conferences with the Appellate Division of the Internal Revenue Service concerning the protest filed by the partnership. Mr. Brandes states that he discussed with the personnel of the Appellate Division "the further point that the taxpayer relied on the acquiescence in entering into the transactions." Attached as Exhibit 3 to this affidavit is the "Action Memorandum" prepared by the Appellate Division on the partnership's protest. Also part of the "Action Memorandum" was a supporting statement justifying the position that deficiency notices be sent to the taxpayers. Every portion of the supporting statement, which relates to securities transactions, has been reproduced and included in Exhibit 3 to this affidavit. Page 3 of the supporting statement refers to a conference on November 8, 1956, attended by Mr. Brandes. At [fol. 52] no place in either the Action Memorandum or in the supporting statement is there any reference at all which even remotely deals with the reliance issue which the plaintiffs seek to raise in their amended complaint.

10. As a result of the recommendation in the Action Memorandum, notices of deficiency were sent to the plaintiffs by registered mail. A copy of the notice of deficiency or, "90-day letter" sent to Mr. W. Palmer Dixon, one of the plaintiffs here, is attached to this affidavit as Exhibit 4.

11. Thereafter, the taxpayers agreed to pay the deficiencies in tax with respect to the securities transactions issue. The supplemental "Action Memorandum" relating to this decision of the taxpayers is attached to this affidavit as Exhibit 5.

12. After the payment of the deficiencies, the plaintiffs filed claims for refund with the District Director. Copies of the claims are attached to the complaint filed herein by the plaintiffs. At no place in the claim for refund is there any reference made to the reliance issue.

13. The refund claims were referred to Revenue Agent Amari and the District Director informed the plaintiffs that he proposed to reject the refund claims. The report of Revenue Agent Amari was annexed to the District Director's letter to the plaintiffs informing them of the proposed rejection of the refund claims. A copy of the District Director's letter to W. Palmer Dixon, one of the [fol. 53] plaintiffs here, together with the annexed report of Revenue Agent Amari, is attached to this affidavit as Exhibit 6. The report of Revenue Agent Amari makes absolutely no reference to the reliance issue.

14. Attached to this affidavit as Exhibit 7 is the report of Agent Amari prepared for the internal use of the Internal Revenue Service. This report again mak s no reference to the reliance issue.

15. As stated in paragraph 9 of Mr. Brandes' affidavit, the plaintiffs waived any further conferences with the Service in connection with the refund claims. Thereafter, the District Director mailed formal notices of disallowance of the plaintiffs' refund claims. A copy of the formal notice of disallowance mailed to Mr. W. Palmer Dixon, one of the plaintiffs here, is attached to this affidavit as

Exhibit 8. Simflar notices of disallowance were mailed to all of the plaintiffs in this action prior to the commencement of this refund suit.

Wherefore, it is respectfully requested that plaintiffs' motion to amend the complaint be denied; that summary judgment in this action be awarded to the United States; that plaintiffs' cross-motion for summary judgment be denied; and that plaintiffs' complaint be dismissed with prejudice and with costs.

Robert Arum, Assistant United States Attorney.

[fol. 54]

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 451—September Term, 1963.

Argued April 30, 1964

Docket No. 28752

W. PALMER DIXON, JOAN DIXON, EVERETT W. CADY, CLARISSA H. CADY, J. HERBERT HIGGINS, MARION BLAIR HIGGINS, STEPHEN A. KOSHLAND, HENRY A. LOEB, JOHN L. LOEB, CARL M. LOEB, JR. and MARGARET L. KEMPNER, as Executors of the Last Will and Testament of CARL M. LOEB, SR., Deceased, HENRY A. LOEB, JOHN L. LOEB, CARL M. LOEB, JR., and ALAN H. KEMPNER, as Executors of the Last Will and Testament of ADELINE M. LOEB, Deceased, JOHN L. LOEB, FRANCES L. LOEB, HENRY A. LOEB, LOUISE S. LOEB, CLIFFORD W. MICHEL, BARBARA R. MICHEL, MARK J. MILLARD, CLAIRE MILLARD, HENRY PARISH 2ND, DOROTHY PARISH, HUBERT R. A. SIMON, SAMUEL L. STEDMAN and GERDA C. STEDMAN, Plaintiffs-Appellants,

HELEN J. GERNON and HELENE G. HIRSON, as Executrices of the Last Will and Testament of FRANK E. GERNON, Deceased, HELEN J. GERNON, Plaintiffs,

—v.—

THE UNITED STATES OF AMERICA, Defendant-Appellee.

[fol. 55] Before: Moore, Smith and Kaufman, Circuit Judges.

Appeal from a judgment of the United States District Court for the Southern District of New York, Levet, *J.*, awarding summary judgment to the United States in an ac-

tion for the refund of income taxes paid. 224 F. Supp. 358 (S. D. N. Y. 1963).

Affirmed.

Bernard E. Brandes, of Stroock & Stroock & Lavan, New York, N. Y. (Sanford Saideman, of counsel), for plaintiffs-appellants.

Robert Arum, Assistant United States Attorney for the Southern District of New York, New York, N. Y. (Robert M. Morgenthau, United States Attorney, of counsel), for defendant-appellee.

OPINION—June 19, 1964

KAUFMAN, *Circuit Judge*:

The sole question presented by this appeal is whether profits attributable to original issue discount on "commercial paper," defined as short-term, non-interest-bearing commercial obligations, are taxable at ordinary income or capital gains rates under the Internal Revenue Code of 1939.[1]

[fol. 56] The relevant facts in this case are free from dispute. Thus, the plaintiffs' amended complaint reveals that during the taxable year 1952, the taxpayers or their spouses or decedents were partners in the investment firm of Carl M. Loeb Rhoades & Co., a member of the New York and American Stock Exchanges. At various times during the year, the partnership purchased thirty-three short-term, non-interest-bearing notes, either directly from the obligor corporation, or through agents or dealers. The notes bore maturity dates ranging from 190 to 272 days from the date of issue, and all were issued at discounts, which varied between 2⅜% and 3¾% of face value. At the close of the

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[1] Unlike the 1954 Code, see *infra*, the Internal Revenue Code of 1939 did not contain any specific provisions with respect to original issue discount. The relevant statutory sections, therefore, are merely §22, which included "interest" in its general definition of "gross income," and §117, which provided for capital gains treatment upon the sale or exchange of a "capital asset."

taxable year, only thirteen notes remained on hand and unmatured; the remaining twenty had been sold during the year—all more than six months after they had been purchased.

In preparing their income tax returns for 1952, each partner reported as a long-term capital gain his distributive share of the profits realized upon twenty notes that had been sold, and no account was taken of the thirteen which remained on hand. Rejecting these computations, the Commissioner determined deficiencies totalling some $369,329.65. In place of the taxpayers' method of analysis, he computed the income earned by virtue of the discount for each day that each of the thirty-three notes were held by the partnership. This earned discount per day was then multiplied by the number of days that the notes were held, and the resulting amount was considered as earned interest, and afforded ordinary income treatment. Having paid the deficiencies assessed, the taxpayers brought this action for a refund.

On cross-motions for summary judgment below, Judge Levet found that the Commissioner had properly interpreted the relevant provisions of the 1939 Code, in viewing the profit derived from the discount as equivalent to interest [fol. 57] income, and accordingly taxing it at ordinary income rates. Although recognizing that §1232 of the Internal Revenue Code of 1954 specifically provides for ordinary-income treatment in original issue discount situations, he concluded that this section was merely intended to clarify the existing law, rather than representing an abrupt departure from the earlier practice. As a result, Judge Levet awarded judgment to the Commissioner, and the taxpayers have brought this appeal.

We should note at the outset that a narrow issue is presented for our decision. It is the taxpayers' contention that the original issue discount resulted in a long-term capital gain, which could only be realized on the twenty notes which were sold; the Commissioner, on the other hand, asserts that the discount produced interest income which must properly be computed for the period that all of the notes were held by the partnership. This dispute as to whether capital gains or ordinary income treatment was

appropriate, moreover, is the only issue that divides the parties. Thus, no question has been raised as to the propriety of taxing the individual partners for notes held by the partnership, and the taxpayers have conceded that if the discount *did* represent ordinary income, that income was realized upon each of the thirty-three notes held, and was not dependent upon a sale.

Turning, then, to the single question in dispute, we find the approach adopted by the Commissioner and upheld below to be plainly correct. Indeed, unless form rather than substance is to carry the day, such a conclusion seems inescapable in light of the facts here conceded. Thus, we are aware of no meaningful distinction, and the taxpayers have offered none, between the discount income involved here and the more traditional forms of "interest on indebtedness," defined in *Deputy* v. *duPont*, 308 U. S. 488, 498 (1940), as "compensation for the use or forbearance of [fol. 58] money." Whatever superficial or mechanical differences in form, both are designed to accomplish the same objective—the production of income for "the hire of money." And this factual identity between discount income, as employed here, and interest income seems both crucial and apparent. In the terms of an illustration offered by the Commissioner, there should be no distinction for tax purposes between a case in which $10,000 is advanced by a lender in exchange for a $10,000 note, payable in one year with interest at 6%, and the original issue discount situation, in which the same $10,000 would be loaned in exchange for a note in the face amount of $10,600. When these transactions are reduced to their essentials, it becomes plain that in both cases, the lender has advanced $10,000, and has received that amount in return, plus $600 in interest. It would seem arbitrary to insist, as do the taxpayers, that significant tax consequences should hinge upon whether this $600 sum is separately stated as interest or is included in the face amount of the note. It has been repeatedly emphasized that our taxing statutes are intended to take cognizance of realities and not mere appearances or facades. See, e.g., *Commissioner* v. *P. G. Lake, Inc.*, 356 U. S. 260, 266-67 (1958).

Without denying the force of this reasoning, the taxpayers argue, however, that capital gains treatment is compelled by the decision in *Caulkins* v. *Commissioner*, 144 F. 2d 482 (6th Cir. 1944). The taxpayer there paid some $15,043.33 over a ten-year period for an "accumulated installment certificate" which returned him $20,000 when the certificate was redeemed. Although recognizing that the certificate was an "evidence of indebtedness" and that the increment in value represented "consideration paid for the use of the amounts paid in," the Court of Appeals for the Sixth Circuit held that the difference between the amount [fol. 59] paid and the sum received on redemption was taxable as a long-term capital gain.

We are willing to agree for present purposes that the notes involved here are analogous to the certificate at issue in *Caulkins*. But in light of our conclusion that original issue discount income is indistinguishable from interest income, we are of the opinion that the *Caulkins* case was wrongly decided. In so holding, we find ourselves in agreement with the greater number of courts to consider the problem. See *Commissioner* v. *Morgan*, 272 F. 2d 936 (9th Cir. 1959); *Rosen* v. *United States*, 288 F. 2d 658 (3rd Cir. 1961); *United States* v. *Harrison*, 304 F. 2d 835 (5th Cir. 1962), *cert. denied*, 372 U. S. 934 (1963); *Pattie* v. *United States*, 311 F. 2d 947 (Ct. Cl. 1963). Contra, *Midland-Ross Corp.* v. *United States*, 214 F. Supp. 631 (N. D., Ohio 1963). Thus, in *Jaglom* v. *Commissioner*, 303 F. 2d 847 (2d Cir. 1962), where we also found that a sum which actually represented interest income must be taxed as such, we noted that "before the 1954 Code specifically covered the subject, most courts held that the excess of the amount received at the maturity of a non-interest bearing note or investment certificate issued at a discount over the cost thereof, being in the nature of an interest return on the capital invested, was ordinary income." 303 F. 2d at 849.

Furthermore, we agree with Judge Levet in his conclusion that the explicit provisions for ordinary income treatment in §1232 of the 1954 Code do not require a different result with respect to pre-1954 obligations. The Senate Committee Report on §1232, indeed, evidences a clear congres-

sional intention to clarify—rather than revise—the existing law. Thus, the Report notes that "under §117(f) of present law, when a corporate . . . bond . . . is retired the transaction is treated as a sale or exchange. There is some uncertainty as to the status of proceeds in these transactions, i.e., as capital gain or as interest income where the [fol. 60] bond or other evidence of indebtedness has been issued at a discount. (See I. T. 3486, 1941-2 C. B. p. 76, as compared with *Commissioner* v. *Caulkins*, 144 F. 2d 482). In these cases, *that part of the amount received on a sale or exchange which may represent a partial recovery of discount on original issue is a form of interest income* and in fact is deductible as an interest payment by the issuing corporation. Effective with respect to bonds issued after December 31, 1954, *the House bill removes doubt in this area* by providing that any gain realized by the holder of a bond attributable to the original issue discount will be taxed as ordinary income." 3 U. S. Code Cong. & Ad. News 1954, at 4745. (Emphasis supplied.)

We find, in sum, that both reason and authority support the position adopted by the Commissioner. The taxpayers, however, urge as a final argument that the Commissioner's acquiescence in the *Caulkins* decision at the time it was rendered precludes him from taking a different position in the present case, even if we agree that ordinary income treatment was proper. We find this contention to be entirely without merit. The Supreme Court has noted that "the doctrine of equitable estoppel is not a bar to the correction by the Commissioner of a mistake of law." *Automobile Club of Michigan* v. *Commissioner*, 353 U. S. 180, 183 (1957). It would seem unduly harsh to hold that a mistaken interpretation of law by the Commissioner of Internal Revenue forever bars the United States government from correcting such an error, and subsequently collecting the taxes rightfully due.

The judgment is affirmed.

[fol. 61]

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Present: Hon. Leonard P. Moore, Hon. J. Joseph Smith, Hon. Irving R. Kaufman, Circuit Judges.

W. PALMER DIXON, et al., Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA, Defendant-Appellee.

JUDGMENT—June 19, 1964

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed.

A. Daniel Fusaro, Clerk.

[fol. 62] [File endorsement omitted]

[fol. 63] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 64]

SUPREME COURT OF THE UNITED STATES

No. 486—October Term, 1964

W. PALMER DIXON, et al., Petitioners,

v.

UNITED STATES.

ORDER ALLOWING CERTIORARI—December 14, 1964

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.